

WIFO

TEL. (+43 1) 798 26 01-0

FAX (+43 1) 798 93 86



ÖSTERREICHISCHES INSTITUT FÜR WIRTSCHAFTSFORSCHUNG
AUSTRIAN INSTITUTE OF ECONOMIC RESEARCH

WIEN 3, ARSENAL, OBJEKT 20 • A-1103 WIEN, POSTFACH 91

P.O. BOX 91, A-1103 VIENNA – AUSTRIA • <http://www.wifo.ac.at>

A New Strategy for Europe **Reaping the benefits of change**

Karl Aiginger

4th Austrian Investor and Business Conference
New York City, April 13th, 2016

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- **Europe: Status 2016**
 - **The new **strategy**: benchmark, 3 principles, 7 drivers**
 - **Developed by 34 teams, at request of EU-Commission**
 - **Kenneth Arrow, Barry Eichengreen, Jeff Sachs on board**
 - **The **hidden potential** of Europe**
 - **Lessons for and learning from **Austria****
 - **Summary**

Annex: data, graphs, documents, figures.

A success model in a difficult stage

- **Indicators of the long run success**
 - From 6 to 28 (+), largest economic area
 - From trade agreement to common market and currency
 - Peace, soft power, spreading "rule of law" (© Jeffrey Sachs)
- **Strengths of Europe:**
 - Rising median incomes, high life expectancy
 - Rather stable world market share, export surplus
 - Manufacturing, energy efficiency, renewables
 - Integration machine (w.r.t. Eastern Europe: © World Bank).

Challenges and weaknesses call for a new strategy

■ Challenges

- Globalization, ageing, heterogeneity, new technologies
- Climate change, political instability, refugees, polarization

■ Weakness signs

- Lost decade, unemployment, R&D gap, poverty
- Governance, Euro crisis, imbalances, exit parties, BREXIT
- “not in a good state” (Junker, 2015); “broken system”

⇒ **New long run strategy** commissioned to 33 teams

⇒ **Karl Aiginger: NEW DYNAMICS FOR EUROPE:**

REAPING THE BENEFITS OF SOCIO-ECOLOGICAL TRANSITION (<http://Synthesis-Summary.foreurope.eu>).

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■ Europe as role model for **successful** regions 2050:

- Stronger **dynamics** based on innovation and human capital
- **Less differences** in incomes, higher employment
- World leader in environmental **technology, energy efficiency**
- Heterogeneous **preferences, pluralistic policy approach**
- Open area, **enjoying globalization**; inviting neighbours

⇒ **A genuine European model of wellbeing**

⇒ **Deepening existing strengths**

⇒ **Not copying US or Asian models.**

High and rising wellbeing

- This benchmark substitutes GDP and GDP growth
- Theoretical underpinning: Beyond GDP concept
 - Stiglitz – Sen – Fitoussi Commission 2009
- Operationalisation
 - Three strategic goals
 - With several objectives within each goal
 - Measurable by Better life indicators OECD, EU.

WIFO ■ The three strategic goals for wellbeing



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- **Simultaneity** between goals and instruments
 - Instead of silo strategies
 - The latter are expensive and inefficient
 - **High-Road-Strategy**
 - Forfeiting low costs and standards (“low.cost competitiveness”)
 - Based on capabilities, ambitions (USP of excellent firms)
 - **Two-stage strategy**
 - First stage: Consolidation and reprogramming
 - Second stage: Socio-ecological transition: given low growth
- First stage not business as usual but**
investment in change: decarbonisation, skill upgrade.

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- **Innovation**: boosting and **redirecting**
 - **Dynamics**: reducing **inequality**, investment in change
 - **Welfare**: from protection to **social investment**
 - **Employment**: **symmetric** flexibility + upgrading skills
 - **Energy**: decoupling and **decarbonisation**
 - **Public sector**: halving **taxes on labour**
 - **Finance**: recommitting to **real economy** & **societal** needs.

Why it should **work this time**:

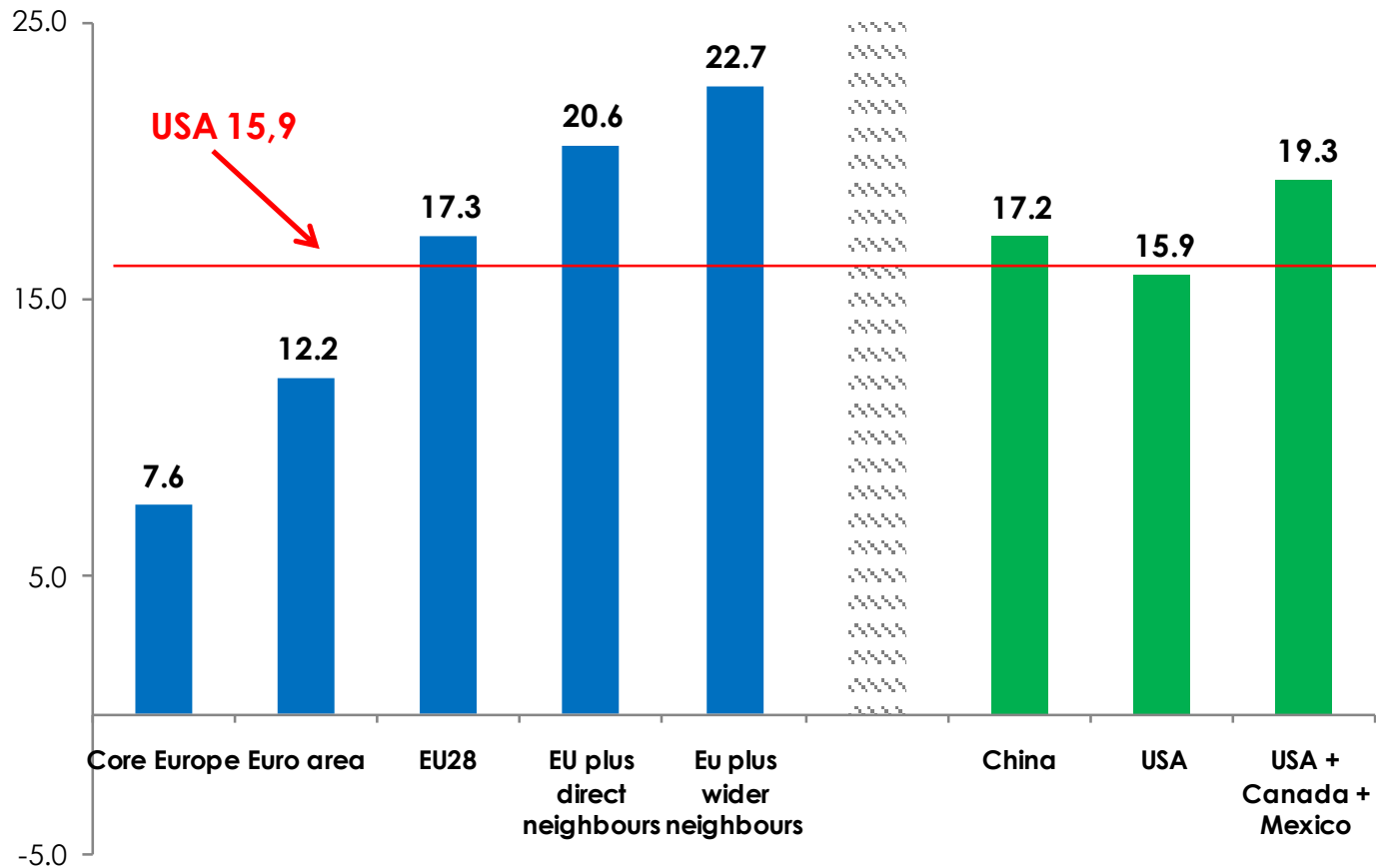
- Going for compromises, **not corner** solutions
- **Bundling reforms**, partial compensation, **fairness**
- Taking business, social **partners**, NGO's on board
- **Inviting youth**, migrants, new actors
- Monitoring progress by **indicators** ("nowcasting" GDP)

⇒ **Necessity of change is understood**

⇒ **Potential for excellence exists.**

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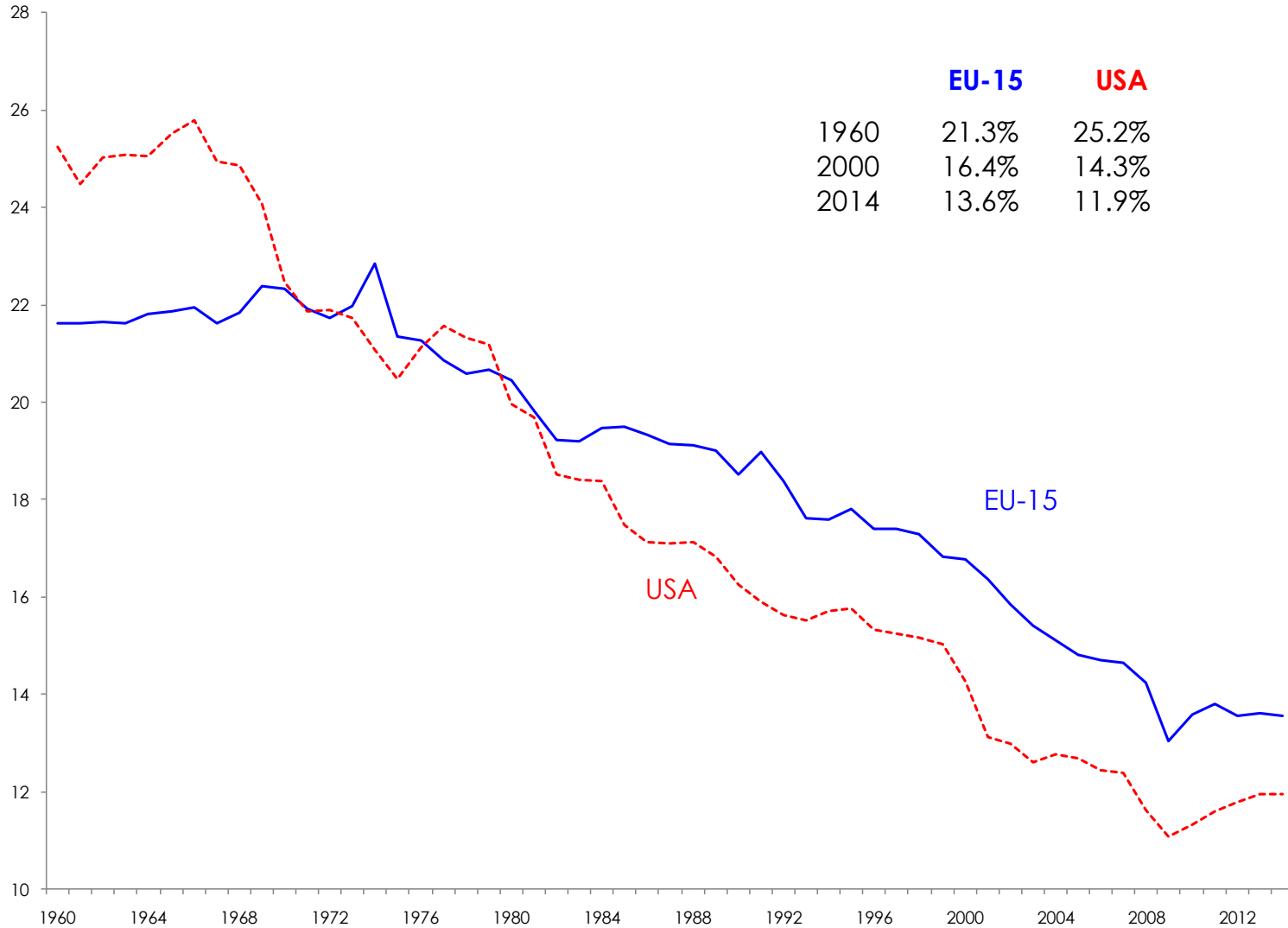
*) GDP based on purchasing-power-parity (PPP), share of world total; IMF (<http://www.imf.org>).

Core Europe: Germany, France, Netherlands, Belgium, Austria, Finland.

EU plus neighbors: Albania, Bosnia and Herzegovina, Kosovo, Croatia, Macedonia, Montenegro, Serbia, Armenia, Azerbaijan, Georgia, Moldova, Ukraine, Turkey, Switzerland, Norway.

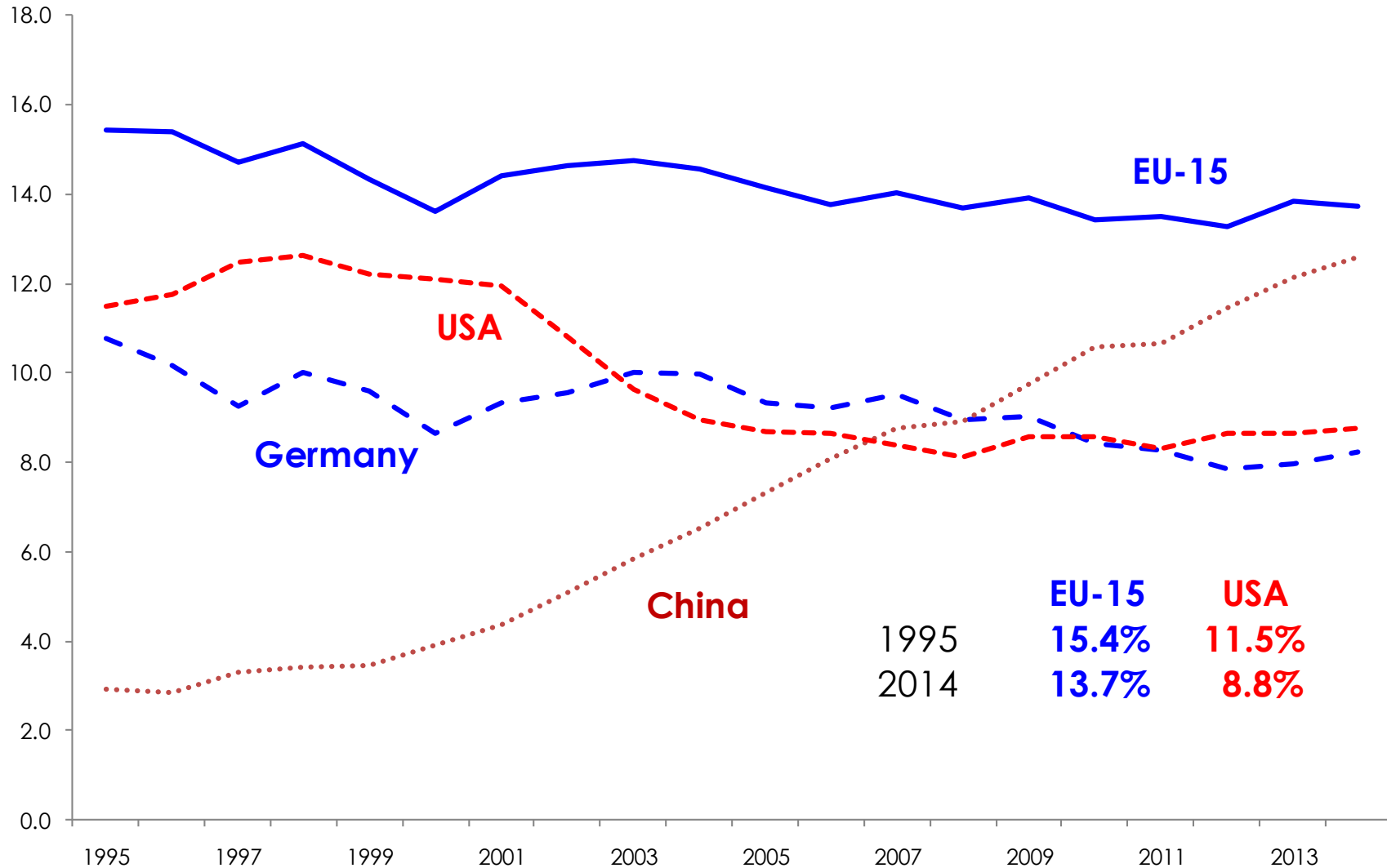
EU plus wider neighbors: Russia, Belarus, Israel, North Africa (Algeria, Egypt, Libya, Morocco, Sudan, Tunisia).

The share of manufacturing in GDP: larger in Europe than in US (at current prices)



Europe: Rather stable world market shares

Share of exports (in % of world exports)



	2010	2050	2010/2050
	Share in GDP in % ¹⁾		% p.a.
Euro area	17.9	8.7	1.5
EU-27	24.2	12.4	1.7
EU plus wider neighbours ²⁾	30.0	28.0	2.5
France	3.5	1.9	1.8
Germany	4.8	1.8	0.9
Austria	0.5	0.3	1.6
USA	22.8	13.3	2.0
China	15.9	23.9	4.5
India	6.3	15.6	5.8

1) OECD members.

2) Albania, Bosnia/Herzegovina, Kosovo, Croatia, Macedonia, Montenegro, Serbia; Armenia, Azerbaijan, Georgia, Moldova, Ukraine, Turkey; Switzerland, Norway.

S: OECD Economic Outlook No 93 - June 2013 - Long-term baseline projections.

Current problems can be turned into part of the solution

- Refugee crisis opens potential for **new dynamics**
 - Argument of ageing and decreasing labor supply is trash
 - Need for common European solutions became evident
- Brexit danger leads to rethinking which issues are regulated
- **Hidden assets of Europe**
 - EU not based on low, stagnant wages and dirty energy
 - Higher importance of energy efficiency, renewables
 - Work life cycle, lower working hours, more leisure
 - Incomes of “low 90%” are rising

⇒ **EU outperforming the US (© Wharton 2015)?**

- **Danger of disintegration (failed “Euro”)**
 - Political polarization within Europe and some members
 - Political instability in neighborhood, return to cold war
- **Muddling through with alternating crises and green spots**
- **Reaping the chances**
 - Decarbonization
 - Lower income spread
 - Experience of heterogeneity
 - Learning from each other and best practice

⇒ **Which scenario is most probable?**

20%: Danger of disintegration (failed “Euro”)

- Political polarization within Europe and some members
- Political instability in neighborhood, return to cold war *

30%: Muddling through with alternating crises and green spots*

50%: Reaping the chances

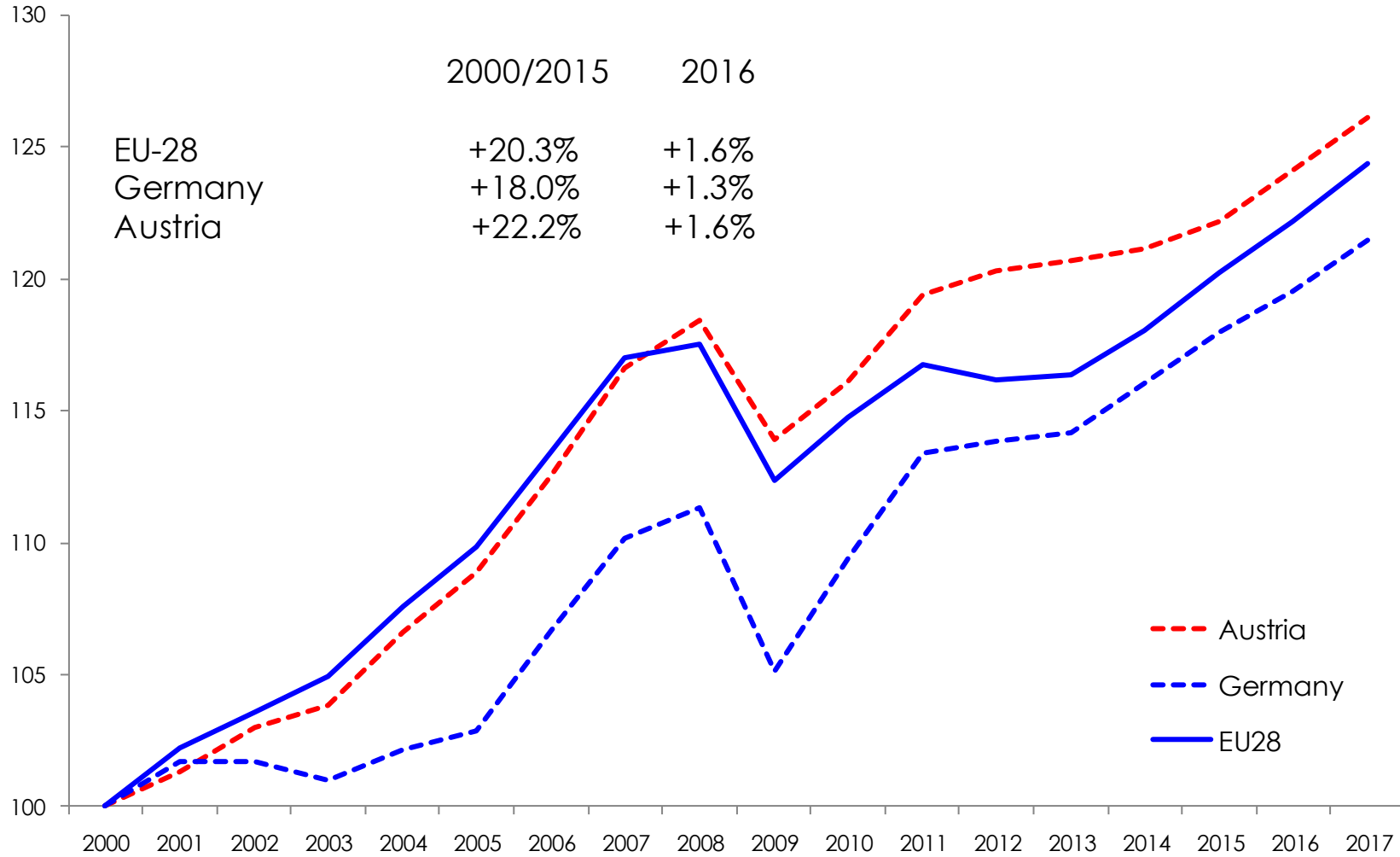
- Decarbonization
- Lower income spread
- Experience of heterogeneity
- Learning from each other and best practice

⇒ The 21st century can still become Europe’s century.

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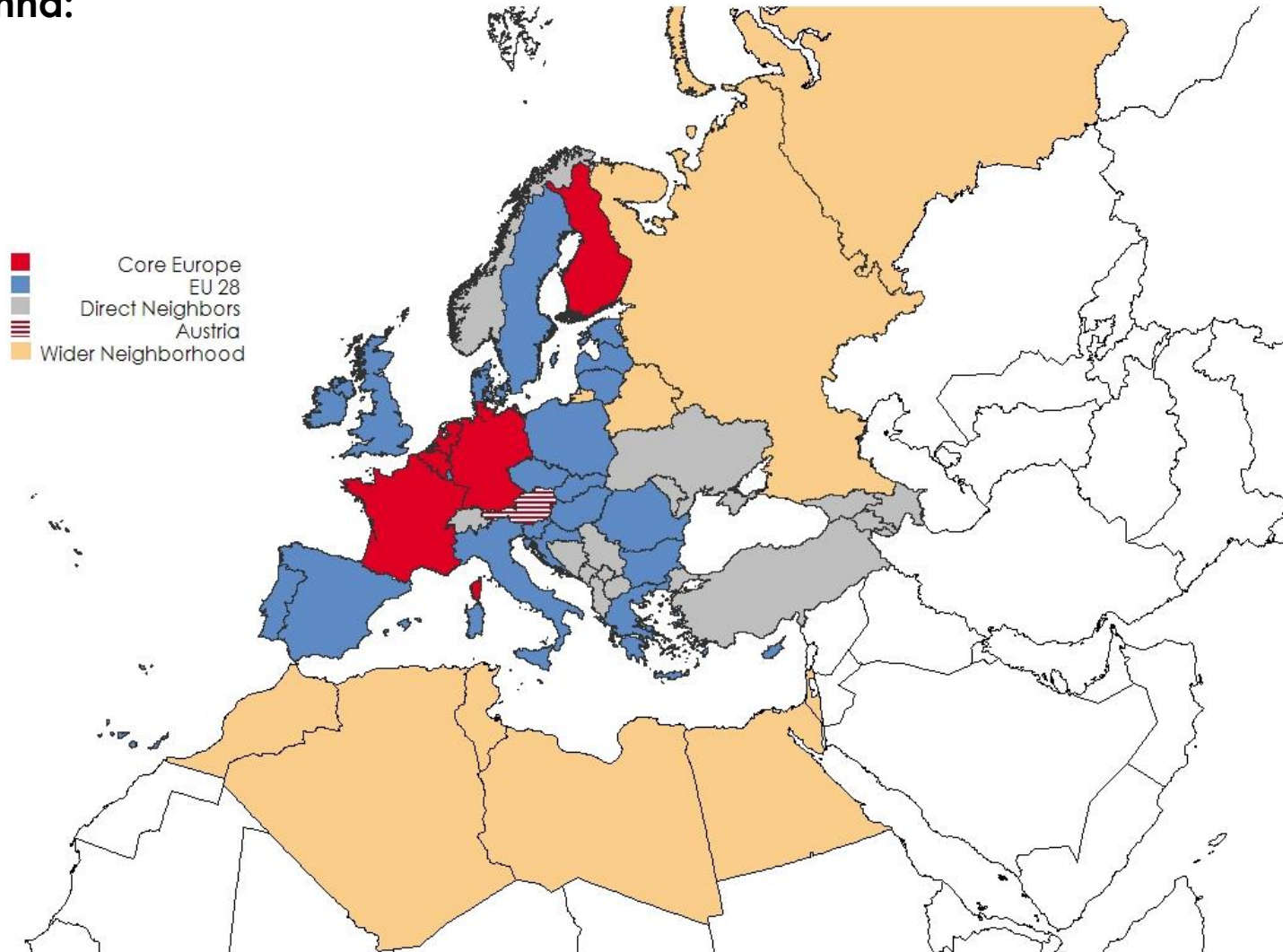
- Wealthy, diversified, large external surplus (3 bn € vs. US)
 - High performance (growth bonus 2000/12), low volatility,
 - Large manufacturing, tourism, high road: 4th in R&D
 - 4th in per capita GDP, 20% above EU, higher than D, F, UK
 - Low unemployment, income spread, stabilizing institutions
 - Top position in environmental technology, renewables
- ⇒ Risks, but even more chances from neighborhood
- ⇒ CEE, Black Sea, Middle East, North Africa.



Equal distance to fast growing neighbors and Western Europe

Distance from Vienna:

- Lisbon 2,900 km
- Tripoli 2,400 km
- Ankara 2,100 km
- Kiev 1,300 km



■ Challenges

- Pressure from emerging countries
- Deepening specialization, **frontier strategy needed**

■ Hangover/low growth 2013-15

- Loss of **market shares** after 12 years of higher growth
- **Crises** in “new neighbor countries”: Ukraine, Russia, N-Africa
- Neglected **low third** and migrants in **education**
- **Leniency** in frontier strategy due to budget consolidation
- Too much money spent for **past priorities** rel. to the future.

- Ageing society leads to labor shortage; **definitely wrong**
- **Inflexibility** of labor, burden by social standards
- High **exposure** of banks, risky **geographical** position
- Public **sector risks** (see maturity, interest, structure of finance)

Chances dominate (if some homework is done)

- Vivid neighborhood (incl. CEE), plus diversification (China, US)
- Fiscal and financial reforms progress, education deficits addressed
- Adequate “model” for more inclusive and decarbonized future

⇒ **Austria grows faster than Germany and EU since 2000**

⇒ **It will match probable top W-Europe in the next decade.**

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- No: continuation of political **inertia** and **pessimism**
- No: sorry, we have **low growth** and a lost decade
- No: sorry, we have **rising emissions** and **higher poverty**

Strategy has to turn problems into growth dynamos

- **Decarbonisation**, empowering the **low third** (unskilled)
- Investing and stabilizing **neighborhood**
- Refugees end labor **shortage** and inflexibilities
- Brexit threat lead to reconsider **overregulation**

⇒ **EU has the potential for the best model of the 21st century**

⇒ **Less income divergences, plurality, lead in sustainability.**

Austria will overcome hangover and - to some extent - lead to new strategy

- High-road strategy, dynamic, open
 - Manufacturing base, high R&D, surplus, diversification
 - Threat of low growth due to ageing no longer founded
 - Investing into vivid neighborhood
 - Dynamics by low income spread and decarbonisation
- ⇒ Chances from neighborhood outweigh risks
- ⇒ Given - homework is done and - strategy is implemented.

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WIFO ■ Austria's "ability to deliver goals"

Beyond GDP goals	Rank Austria	Strength	Lead country
Income pillar	2	Household income	Luxembourg
Social pillar	4	Youth unemployment	Netherlands
Ecological pillar	7	Share of renewables	Italy
Overall wellbeing	2	Income	Sweden

Karl Aiginger: A New Strategy for Europe, Vienna-Brussels, 2016 (<http://Synthesis-Summary.foreurope.eu>).

Low growth in core Europe: vivid neighborhood

	2000/2015	2000/2020	2010/2015	2015/2020
Germany	1.1	1.2	1.6	1.4
France	1.1	1.2	0.8	1.7
Core Europe¹⁾	1.1	1.2	1.1	1.5
Euro area	1.0	1.2	0.6	1.6
EU28	1.4	1.5	1.0	1.9
EU plus direct neighbours ²⁾	1.6	1.7	1.2	2.1
EU plus wider neighbours³⁾	1.9	1.9	1.2	2.0
EU-CEE ⁴⁾	3.2	3.2	2.3	3.1
North Africa ⁵⁾	4.1	4.3	3.1	4.6
USA	1.8	2.0	2.1	2.5
China	9.6	8.7	7.8	6.2

1) Germany, France, Netherlands, Belgium, Austria, Finland.

2) Albania, Bosnia and Herzegovina, Kosovo, Croatia, Macedonia, Montenegro, Serbia, Armenia, Azerbaijan, Georgia, Moldova, Ukraine, Turkey, Switzerland, Norway.

3) Russia, Belarus, Israel, North Africa⁵⁾.

4) Bulgaria, Croatia, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovak Republic, Slovenia.

5) Algeria, Egypt, Libya, Morocco, Sudan, Tunisia.

WIFO ■ It has to be a high-road strategy

- **Productivity** more important than costs
 - **Competitive advantage:**
 - Quality, sophisticated products, technology
 - **Growth drivers:**
 - Innovation, education, universities
 - **Ambitions/Institutions:**
 - Social empowerment, ecological excellence, trust
 - **Objectives: Three strategic goals**
- ⇒ **Europe has to go for a high-road strategy.**

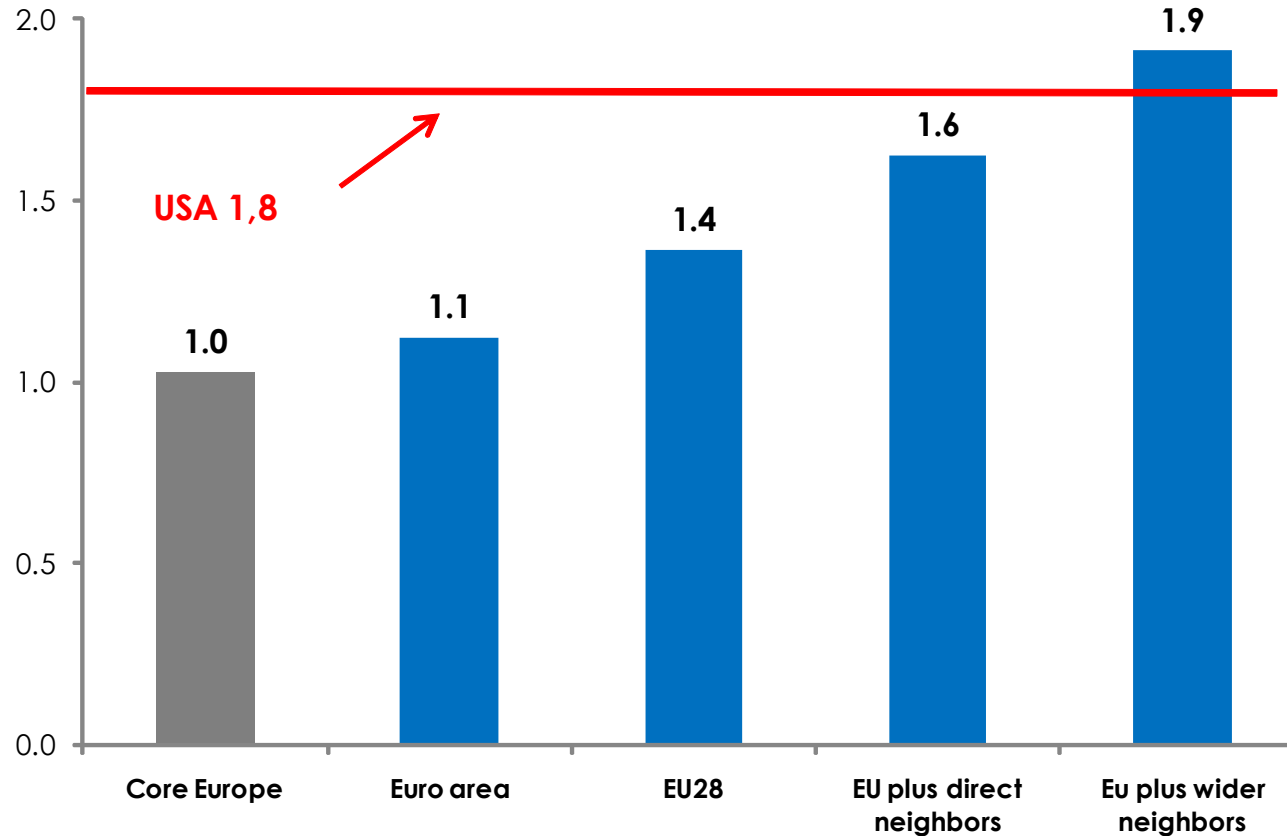
WIFO ■ It has to be a two-stage strategy

- In the very long run (rich countries) will have lower growth
 - Supported by decreasing marginal utility of income
 - Increasing non material values with rising income
 - Burn outs are neither warranted nor necessary
 - But over the **next 10 years** we have to have decent growth
 - For returning to full employment, paying back public debt
 - Favouring redistribution
 - Jobs for migrants and refugees
 - Driven by investment in decarbonisation and social innovations
- ⇒ **Tripling GDP up to 2100 (1.5% p.a.) neither feasible nor warranted.**

Even the first stage cannot be **business as usual** but **investment in change**

- New **infrastructure** much less dependent on fossils
 - **Social** innovations prepare for second stage
 - Changing institutions, **behaviour**, awareness
 - Redefine competitiveness towards **beyond-GDP** goals
 - Reduce dominance of GDP, address **goals directly**
 - Start **double decoupling** (emission **and** labour)
 - Support industry moving towards **4.0** (lower material/ energy)
- ⇒ **Energy Roadmap 2050**
- ⇒ **Zero Net Emission Goal (OECD, COP 21 Paris 2015).**

Low growth in core Europe: vivid neighborhood (2000-2015)



*) Gross domestic product based on purchasing-power-parity (PPP), share of world total.

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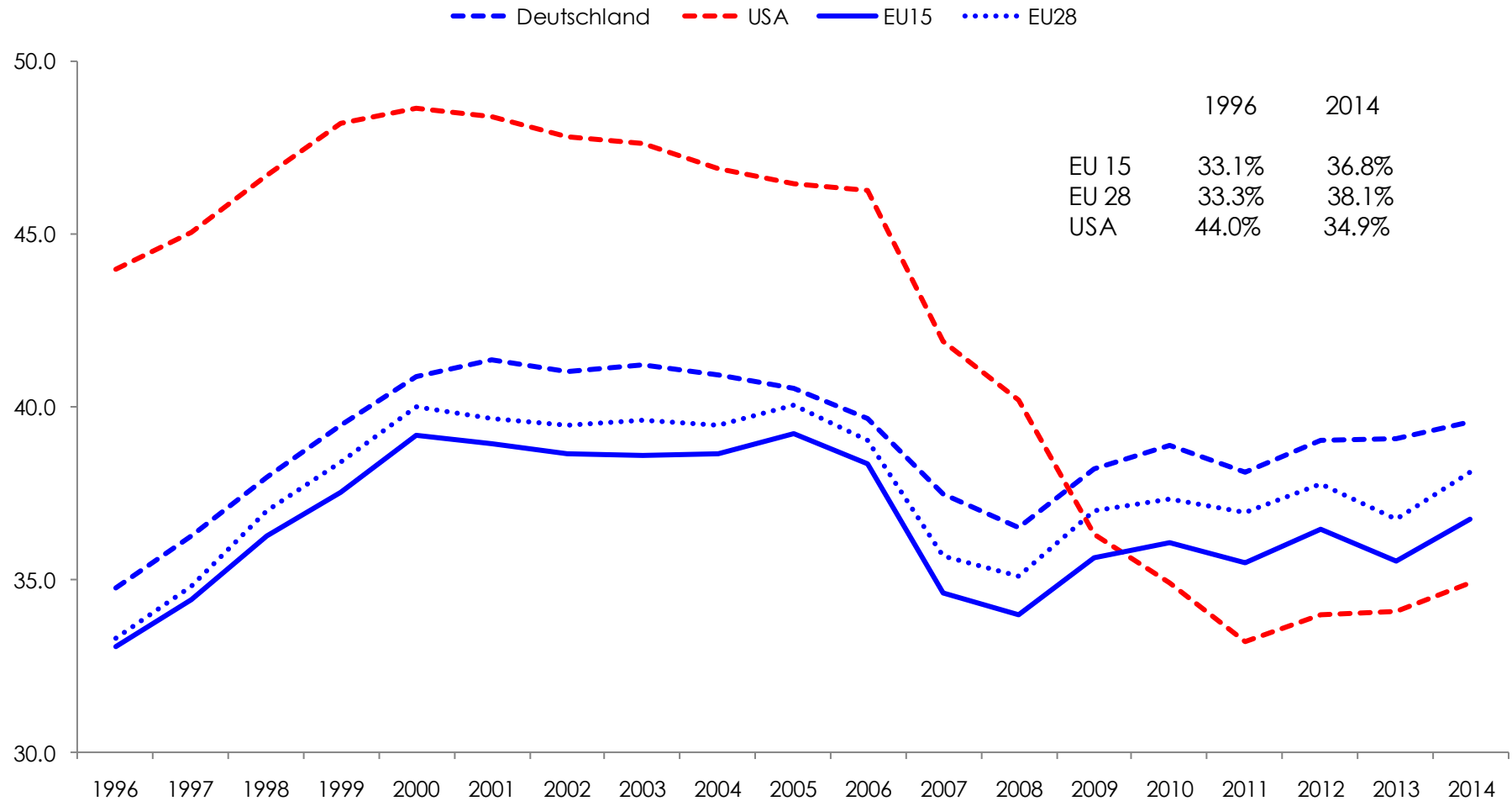
EU plus wider neighbours: Russia, Belarus, Israel, North Africa (Algeria, Egypt, Libya, Morocco, Sudan, Tunisia).

Source: World Economic Outlook, October 2015, International Monetary Fund. <http://www.imf.org>

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- **Core Europe:** Germany, France, Netherlands, Belgium, Austria, Finland.
 - **Direct neighbors:** Albania, Bosnia and Herzegovina, Kosovo, Croatia, Macedonia, Montenegro, Serbia, Armenia, Azerbaijan, Georgia, Moldova, Ukraine, Turkey, Switzerland, Norway.
 - **Wider neighbors:** Russia, Belarus, Israel, North Africa.

Source: *World Economic Outlook, October 2015, International Monetary Fund.* <http://www.imf.org>

Equalizing US position in technology driven industries in exports



- **EU: 'not in a good state': economically, public opinion**
 - **Pessimism will phase out if there is a forward-looking strategy**
 - dynamics, employment, lead in decarbonisation
 - **Europe will become a success model again**
 - investment into change
 - exchange with neighbours (Fulbright, ERP)
- ⇒ **Europe will become the best model for dynamic high-income regions.**

- **Pressure from catching up economies**
- **Dependent on external demand as small country**
- **Upgrading skills of lower third neglected**
 - **Integrating migrants (2nd gen) into school and training**
 - **Needed: Adapting vocational training**
 - **Frontier strategy for universities and innovation**
- **Deepening specialization and smart diversification**
- **Loss of market shares by political instability and investment trough**
- **Mobilizing structures and redirecting public sector.**

- **Public debt is medium, private debt is low**
- **Financial risks low (interest, maturity, structure, rating)**
- **Structural deficits are decreasing, Heta risk exists but "priced in"**
- **Share of public sector large, inefficiencies abundant**
- **Public sector pays for pensions for those not needing support**
- **Governance reforms could reveal big chances**
 - **For cutting expenditures, taxes**
 - **Boosting investment in skill**
 - **Innovation, ecology**
- **Labor highly taxed; energy, tobacco, alcohol, transport not.**

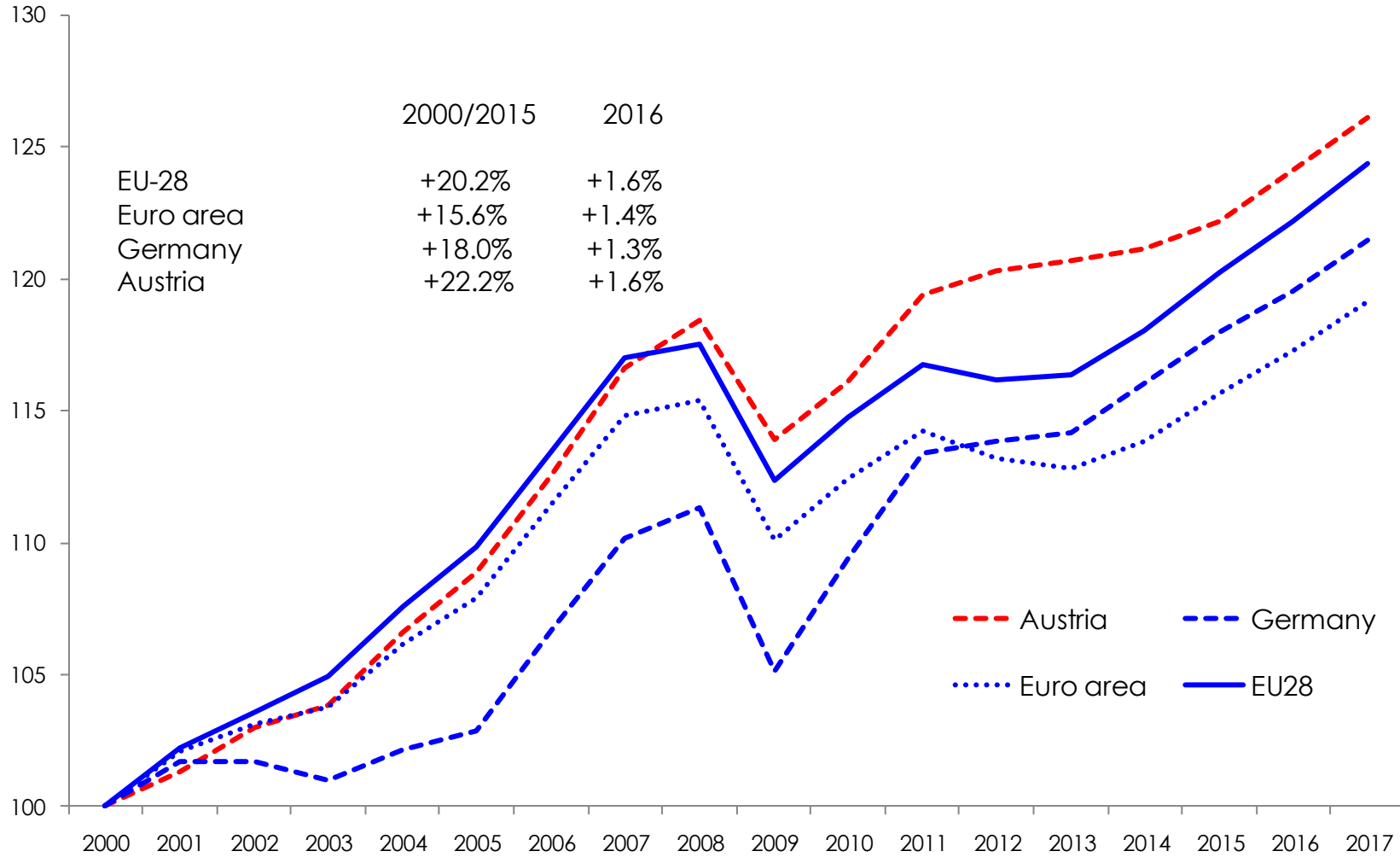
- Exposure to Central, Eastern and SE-Economies (CESEE)
- 60% (gross) and 40% (net) of GDP, but rather diversified
- Restructuring has taken place, Banking supervision
- Restructuring and resolution Act 2015
- Strong institutions, sometimes reluctant to change
- ⇒ Pro-European opinions dominate, critical to EU governance
- ⇒ Refugee crisis favors right wing tendencies incl. admiration for authority.

- **Potential: rising population & vivid neighborhood**
- **Successful diversification (China, US)**
- **External surplus, low private debt, public deficits declining**
- **Need for continuous reforms & technological excellence is on rise**
- **In Austria critical about public sector and institutions (bureaucracy) in all rating reports strong institutional effectiveness!!!**

- Frontier or backlash **innovation system**
- **Upgrading skills** or polarization
- **Political integration** vs. extreme parties
- Deploring the past or **investing in future**
- Low trend in labor productivity, **higher in resources**
- Inside orientation (fences) or **enjoying diversity, heterogeneity.**

-
- **Lower growth based on ageing/ declining work force**
 - Is now definitely wrong; increasing supply up to 2030
 - And even later if migration trends continue
 - **Headline fiscal deficit declines (disguised by HETA resolution)**
 - **Recovering CEE, peace in neighborhood vs. refugees**
 - **Persistent large current account surplus**
 - Positive net investment position
 - **Great challenges Austria, larger chances.**

Austria's growth since 2000 – higher than in Germany



WIFO ■ Europe: A new strategy is needed

- Based on strengths and preferences
 - “Europe is not in a good state”, economically, public opinion
 - Pessimism and ad hoc solutions are overcome by a new strategy
 - Dynamics, employment, lead in decarbonization
 - Problems can be turned into solutions
 - Refugees and labor shortage and inflexibility
 - Increase awareness of common solution needed
 - Brexit referendum helps to rethink what has to be regulated
- ⇒ Europe has the potential for best model for rich regions
- ⇒ Less income divergence, plurality, lead in sustainability.